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Dianne Wampler 07/19/2006 09:00:14 AM From DB/Inbox: Dianne Wampler

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Text:

C O N F I D E N T I A L ISTANBUL 01296

SIPDIS

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ACTION: ECON
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INFO RUCNCIS/CIS COLLECTIVE PRIORITY
RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY
RUEHAK/AMEMBASSY ANKARA PRIORITY 5346
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C O N F I D E N T I A L SECTION 01 OF 03 ISTANBUL 001296

SIPDIS

ENERGY FOR D/S SELL

E.O. 12958: DECL: 07/18/2016

TAGS: ENRG TU

SUBJECT: JULY 12 PRESIDENT ALIYEV - ENERGY DEPSEC SELL
MEETING

Classified By: Consul General Deborah K. Jones for reasons 1.5 (b)
and (d)

¶1. (U) This is a joint ConGn Istanbul-Embassy Baku message.

¶2. (C) SUMMARY Azerbaijani President Ilham Aliyev told Deput Secretary of Energy Clay Sell on July 12 that Azerbaijan and US goals and strategies with respect o developing Azerbaijani gas for world markets cincide, and Azerbaijan is prepared to coordinate nd cooperate with the U.S. to make the project areality. He said we are losing time and need tomove quickly, noting that 2007-2008 are crucial,especially for Georgia and Azerbaijan. Aliyev oted that "Azerbaijani gas ruins Russia's strategy nd political vision for the long term" and that Russia will fight in this case." He said that hi good relationship with Putin had forestalled Rusian pressure on Azerbaijan for the moment, but e is cautious in awakening Russian concerns, telling the Russians for now that only Turkey and Geoga are Azerbaijan's prospective gas markets. TheRussian have realized they have an important too in others' dependence on them for gas supplies, and they will use it. He noted that USG support for BTC had been "decisive," and similar USG suport would be necessary on gas. Aliyev said he welcmed the USG's offer to provide new ideas on how e can strengthen and expand our dialogue on economic policy, liberalization and reform, noting that we have "big potential" to build our economic tes in areas other than energy. END SUMMARY

¶3. () Deputy Secretary of Energy Clay Sell met on July 12 in Istanbul with President of Azerbaijan Ilhan Aliyev. Sell was accompanied by Ambassador Ross Wilson, Ambassador Anne Derse, Ambassador Steve Mann, A/S for Economic Affairs Daniel Sullivan, DAS for European Affairs Matthew Bryza and DOE representatives.

AZERBAIJANI GAS FOR EUROPEAN MARKETS

¶4. (C) DepSec Sell congratulated Aliyev on realizing the Baku-Tbilisi-Ceyhan pipeline. Aliyev, after sending his "best greetings" to President Bush with thanks for an excellent meeting last April, underscored that the USG role in BTC had been "decisive." Without USG support and engagement, BTC would not have been achieved, Aliyev said. He looked forward to continuing this cooperation and "strong partnership" on the next stage -- a "new, more global stage." BTC, he noted, had been more or less a regional project. With the recent conclusion of the Inter-Governmental Agreement (IGA) with Kazakhstan, it has become a global project.

5.(C) Aliyev said he initially had not thought of Europe as a market for Azerbaijan's gas resources. But gas is now becoming more important. Demand is growing and Azerbaijan needs to "review" its approach on gas. The first phase of the Shah Deniz project has a market in Azerbaijan and Georgia. Russia is not likely to cut off gas supplies because that step would also cut off supplies to Armenia and the second existing pipeline is used mainly for electricity, he noted.

¶6. (C) Nonetheless, Aliyev underscored, the situation with Russia now is "very serious," and "demands a new production profile and a new distribution profile." SOCAR has begun a program to increase gas production by 1million cubic meters by 2007 and 1 million more in 2008. Azerbaijan has plans for SOCAR to work in currently abandoned fields, and Shah Deniz as well, although SOCAR's share in Shah Deniz is only 10 percent. Working with partners to increase gas production, and to get Kazakhstan involved, is Azerbaijan's "number one priority." Aliyev said. It will create "a new situation in the region." However, Aliyev cautioned, "without the U.S., it won't work." Azerbaijan, Turkey, Georgia, Kazakhstan, maybe Turkmenistan and southern Europe should have a "coordinated program" involving all the players. The approach taken on BTC is a model.

¶7. (C)Turkey will not be ready until mid-2007 to receive Azerbaijan's gas, Aliyev said. Azerbaijan is therefore discussing changing the proposed distribution from 2.9 bcm to Turkey, 2.5 bcm to Azerbaijan and .3 bcm to Georgia to a new distribution, reducing Turkey's 2.9 bcm, and sending some of it to Georgia and Azerbaijan instead. "If they can receive it, we'll send it," Aliyev said. Gas prices, low before, are now high, he added - \$110 for Georgia and Azerbaijan will be up to \$200 in 2007. How can Azerbaijan explain to its people that it is selling its own gas to Turkey for \$120, and buying from Russia at \$200, Aliyev asked rhetorically? Aliyev said he had sent a delegation to Turkey to discuss the situation, and that he, Georgian President Saakashvili and Turkish PM Erdogan would also meet to "clarify who gets what."

¶8. (C) Aliyev later told DAS Bryza that the three had met and that he, Turkish PM Erdogan, and Georgian President Saakashvili agreed earlier in the day that Turkey would forego its right to purchase an additional 20% of its contracted volume from Azerbaijan at the relatively low cost of \$120 per thousand cubic meters. That gas could then be sold both to Georgia and back to Azerbaijan. Aliyev said this agreement would be contingent on Georgia agreeing to support the Kars-Tbilisi-Baku railroad, which will bypass Armenia. (Comment: This would be a significant breakthrough on gas supply for Georgia, on which we've worked for nearly a year. End Comment). Aliyev recognized that the U.S. Congress voted to block USG financing for a railroad

bypassing Armenia, and asked "simply that the U.S. not actively oppose" the Kars-Tbilisi-Baku railroad.

¶19. (C) Aliyev stated that there is a serious possibility Russia will cut Azerbaijan off on the grounds that "if you are selling into our market, why should we sell to you?" There is "no clear picture" yet with Greece, Turkey and Russia, Aliyev said, "but we need to work it out by the end of the summer."

10.(C) DepSec Sell urged Aliyev to "hold tight." He told Aliyev the U.S. will help in anyway possible, and will stand with Azerbaijan in support of the very important long term decisions to be made and in holding fast against Russian pressure. Pleased, Aliyev responded that "U.S. and Azerbaijan goals and strategies coincide," the two countries are "strategic partners" at an important new juncture for determining future energy supplies. "We must coordinate and cooperate in our approaches," Aliyev said.

11.(C) Russia has now realized that it has a very strong instrument to use and this is very serious, Aliyev repeated. Efforts to develop and sell Azerbaijani gas to Europe is "not just a local project...we may face very strong pressure from Russia." Aliyev said he has a strong relationship with President Putin and that Azerbaijan is "working with and talking to" the Russians, which has "delayed the pressure some." But Russia will remain a very important supplier of gas for years to come. The Baltics are 100 percent dependent on Russia. Europe has no single policy on energy and EU countries "act separately" vis a vis Russia, he added, pointing to former President Schroeder,s association with Gazprom.

¶12. (C)Fundamentally, "Azerbaijani gas ruins Russia's strategy and political vision for the long term," Aliyev stated. He therefore tells the Russians, for the moment, that Azerbaijan's markets are Turkey and Georgia. "We shouldn't wake them (the Russians) up too early -- every year we gain is important," Aliyev stressed. 2007 will be crucial for Georgia, in particular. By 2008, Shah Deniz will produce 9bcm and by 2010 12.5bcm.

¶13. (C) Aliyev stressed the need to create facts on the ground, rather than picking up a rhetorical fight with Gazprom. The key fact on the ground would be to gain access for Azerbaijan,s gas to European markets. To secure access to the European market it is "very important that Turkey (in 2007) not take the gas designated for it so we can cover Azerbaijan and Georgia, then in 2008, we can start delivery to Europe." While Greece is the key entry point for Azerbaijan,s gas, Greece's demand is small, 2 or 3 billion, the symbolic importance to markets of gaining a share of the Greek market is crucial. Azerbaijani Finmin Sharifov had very good discussions with the Greeks. "We must always consult and coordinate," Aliyev underscored again. The lack of a single EU policy means the EU is not the right organization to coordinate additional supply sources, in his view. Putin has threatened that Russia has a market in China to which it can divert its gas. He can use that leverage with the EU, Aliyev said. Aliyev was grateful to the U.S. for convincing him to send Sharifov to Athens.

¶14. (C) Time is very important, and we are losing time, Aliyev continued. Shah Deniz was BP's "last priority." Aliyev said he had asked the EU for an energy dialogue in 2004, without success. As a result two years were lost. "For us, the time is now," he said. 2007-2008 are very important years, including with respect to involving Kazakhstan, which will be a big gas producer. Kazakhstan will join in the project only after Azerbaijani gas is in Greece, Aliyev said. That was the lesson from BTC, when Kazakhstan signed the IGA just shortly after the first oil was loaded in Ceyhan. Supplying Europe means a lot for Kazakhstan, which has leadership aspirations, including a desire to chair the OSCE.

¶15. (C) The whole regional picture will change with respect

to regional development, western orientation and long term stability once the gas project is realized, Aliyev concluded. But without the USG's strong support, it will be hard to implement. "Russia will fight in this case," Aliyev averred.

NEXT STEPS ON BTC

¶16. (C) With respect to next steps on BTC, Aliyev said Azerbaijan is working with investors with respect to the host government agreements to follow the IGA with Kazakhstan. They will negotiate and then develop the infrastructure, including from Kashagan. A tanker fleet of five vessels of 60,000 tons must be constructed which will take 3-4 years. The connection to the BTC in Azerbaijan, the Kazakhstan to port connection, will be key. With existing tankers, only 20 m tons can be carried. Investors are very interested; Chevron in particular is very active now. Only a subsea pipeline will do the job; this is technically possible but will draw political complaints from neighbors, especially Iran and Russia. It will be easier to move ahead if a deal with Kazakhstan is in place first, Aliyev said.

NEW ECONOMIC DIALOGUE

¶17. (C) As a way to strengthen the broader U.S.- Azerbaijan partnership, A/S Sullivan outlined for Aliyev the possibility of elevating and broadening our economic policy dialogue. This could include liberalization, reform, trade and investment issues, enhancing commercial ties and addressing the challenges of managing oil revenues and broad-based development. He suggested the USG would provide ideas soon on how to structure a new dialogue. Aliyev readily agreed, noting that we have "big potential to strengthen our economic ties," in areas other than energy. COMMENT: In a pull aside later that day with FinMin Sharifov, who told Ambassador Derse on July 11 that he is prepared to work with the USG to move towards "burden sharing" on assistance as Kazakhstan has done (septel), we relayed the proposal and noted Aliyev's interest. Sharifov too welcomed the proposal and thanked A/S Sullivan for his willingness to lead the dialogue.

¶18. (U) Deputy Secretary Sell's party was unable to clear this message prior to departure.

JONES